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UNCLAS SECTION 01 OF 02 ANKARA 002161

SIPDIS

SENSITIVE

TREASURY FOR OASIA - C. PLANTIER

E.O. 12958: N/A
TAGS: EFIN TU
SUBJECT: Turkish Parliament Moves on IMF Prior Action

Sensitive but Unclassified.

¶1. (SBU) Summary: With the April 14 passage of a new Tax Administration Reform law, Turkey has satisfied the remaining "prior action" for finalizing a Letter of Intent (LOI) for a new three-year IMF stand-by program. However, differences with the IMF over controversial amendments to the regional investment incentives law still need to be resolved before final Executive Board approval of the program, which both Fund staff and the Turks expect to happen in May. Even after approval, implementation of a new program will continue to be rocky and difficult. End Summary.

¶2. (SBU) The Turkish Parliament finally adopted the long delayed Tax Administration Reform Bill on April ¶14. Under this reform, Turkey will establish a separate and a more powerful tax administration office. This should create a more efficient revenue collection system that will help reduce the size of Turkey's unregistered economy, which is estimated to account for 40-50% of the total economic activity. The law will abolish the existing General Directorate of Revenues (GDR) and replace it with an independent Tax Revenue Administration. The Finance Ministry will continue to make tax policy, but the new Tax Administration will be in charge of implementing these policies. The law will also require establishment of Regional Tax Administration Units. Despite the law's good intentions, Yuksel Karaca, Deputy Director-General of the GDR expressed skepticism to ECON Specialist about how it will be implemented. He opined that the law would do little more than change the names of already existing units.

¶3. (SBU) An IMF mission, which had been in Ankara for 10 days, completed its work and held a press conference together with State Minister Ali Babacan on April 12. In the press event, the two sides said they had finalized agreement on the details of the economic program described in the Letter of Intent, which remains to be approved by Fund management. Minister Babacan reiterated his expectation that the IMF Executive Board will meet in the first half of May to approve Turkey's LOI. Although both sides gave a positive picture, the IMF mission left Ankara without completely resolving differences over the regional investment incentives law. The GOT has come up with a new formula that would, according to press reports, increase the number of provinces covered by the law, but reduce the scope of the financial incentives, with a resulting lower overall cost than was originally proposed. The Prime Minister has apparently not yet given final approval to these revisions and the Turks and IMF have not yet resolved how the additional cost will be accommodated within the 6.5% of GDP primary budget surplus target. Babacan, however, claimed that the cost would be negligible. Karaca told Econ Specialist that his department had discussed the Incentives Law with the IMF, reached agreement on certain aspects of the Law, and come up with a cost figure, which he could not share at this stage. Karaca said the total and real cost of the new incentives to the budget would only be clear once Parliament adopts the Law. (The law is currently being reviewed by Parliamentary subcommissions.) In the same press conference Minister Babacan announced revision of some macro economic targets such as the current account deficit, based on the latest economic data releases. The message given was that although the Turkish economy has posted a remarkable improvement, some challenges remain.

¶4. (SBU) Comment: Implementation of the new program will be just as controversial and difficult as its negotiation. While Turkish officials continue to reiterate the government's commitment to fiscal discipline using every available platform, they don't hesitate to surprise the IMF and the markets at the same time with heterodox proposals like the incentives law expansion, which -- as an IMF official commented

privately -- is "economic nonsense." Again, just after the IMF mission left town, Finance Minister Unakitan hinted at the possibility of a cut in the current 18% value added tax rate for textile and ready-to-wear products. In addition, it appears that implementation of the tax administration reform will be an ongoing issue, as will the complicated and politically sensitive social security and banking reforms laws that are still subject to parliamentary debate and further challenges. Surprisingly, markets showed little sensitivity to the delay in approval of a new program until May, despite what some perceive to be a deteriorating global emerging markets environment. Under an environment of increasing oil prices and volatile emerging markets, the GOT will have to pay more attention implementing prudent economic policies if it is going to continue to be able to finance its high current account deficit with foreign inflows.
Edelman